

PTIF News

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Points of Interest

- Historically low interest rates seem here to stay
- Understand what it means when a bank is subject of a “formal enforcement action”

From the Treasurer’s Desk

Fragile Stability

Two years ago this past August, “subprime mortgage” became a household term. A problem that was first considered “contained” spread like a pandemic throughout the financial markets.

And just one year ago, the markets were on the verge of collapse, as Lehman Brothers filed for bankruptcy and the federal government stepped in to prop up AIG and to take control of Fannie Mae and Freddie Mac. Wary investors hoarded cash as

credit markets froze, and corporations were unable to sell debt securities under any terms.

Today, the markets have returned to relative stability, however fragile. The Federal Reserve Bank remains committed to keeping short-term interest rates at or near zero. Corporations are now issuing debt, but are using mostly long maturities to take advantage of these historically low rates.

Short term investors like the PTIF are now faced with limited investment options

that, due to simple supply and demand imbalances, trade at premium prices which further depress returns.

Until the Fed believes the economy is more clearly on a path towards recovery, short term interest rates will continue at extremely low levels. For PTIF participants, this means modest returns are here to stay for the foreseeable future.



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Inside this issue:

Banking Update	1
PTIF & Market Review	2

Banking Update: Formal Enforcement Actions

On July 16, 2009, Utah’s Money Management Council took unprecedented action. Responding to recently announced **formal enforcement actions** issued by federal banking regulators, the Council reduced by 50% the uninsured public funds allotments of three banks targeted by those regulatory actions. Since that initial step in July, a total of *eight* Utah banks have likewise seen their allotments reduced after becoming subject to formal enforcement actions.

As with bank failures, the number and frequency of formal enforcement actions

has increased sharply over the past year. In all of 2008, the FDIC issued just over 90 such actions, and has issued **180** actions already this year.

Due Diligence Is Required

Citing the importance of due diligence, the Utah Department of Financial Institutions has stated that “the only assurance a public treasurer has to prevent loss of public funds is to keep deposits under the FDIC or NCUA insurance limits at each qualified depository. If deposits at one institution exceed insured limits, it is incumbent on the public treasurer to perform

due diligence on that institution.” Due diligence in this environment requires an understanding of formal enforcement actions, how banks are reacting to them, and how to discern a bank’s prospects for successful resolution of the issues raised by regulators in the process.

A Definition

Enforcement actions provide bank regulators with a standardized mechanism for communicating deficiencies in a bank’s condition and for outlining corrective actions (both do’s and don’ts) that

(continued on page 3)

Market and PTIF Portfolio Review

Most analysts believe the deepest and longest recession in recent memory is behind us as financial markets worldwide are returning to normal. This recession has been marked by significant deterioration in every major economy, underscoring the growing linkages in world financial markets. The financial meltdown caused more than \$1.6 trillion in losses at the world's largest financial institutions. The IMF estimates that global loan losses could exceed \$3.4 trillion in total. Developed nations have launched unprecedented and coordinated monetary and fiscal efforts aimed at pulling the global economy from recession to recovery - time will tell if these actions are sufficient.

Stimulus spending is helping the economy to a degree, financial markets are stabilizing, and recent data from the housing market has been encouraging. However, U. S. job losses continued to mount last month and the unemployment rate climbed to its highest level since 1983. October payrolls dropped by 190,000, and the jobless rate rose to 10.2%. Since the recession began in December 2007, 7.3 million jobs have been lost, the biggest decline since the Great Depression. Even though employment data is considered a lagging indicator, it remains a cause for concern due to its tie to consumer spending, a key driver of economic growth.

Fed Chairman Ben Bernanke suggested in mid-September that the U.S. recession had probably ended. Advance estimates from the Bureau of Economic Analysis show third-quarter GDP growth of 3.5% - the U.S. hasn't posted growth in quarterly GDP since the sec-

The combination of record low rates and a persistent lack of available securities continues to create challenges for short term investors. As indicated in Figure 1, the PTIF continues to provide a high degree of liquidity, by maintaining over 26% of the portfolio in overnight money market mutual funds.

Another major factor impacting the portfolio is the dramatic decline in the 3-month LIBOR rate, from .63% at the end of the second quarter to .29% at the end of the third quarter, as illustrated in the "key rates" table below. With rates on over 50% of the portfolio re-setting quarterly, and with the majority of securities indexed to the 3-month LIBOR rate, yields in the portfolio can be expected to decline further.

The key rates table also illustrates how the flight to safety has impacted treasury security yields over the last year, as investors have poured funds into treasuries. Public treasurers should exercise caution if tempted to chase yield at this stage of the interest rate cycle. With the risk-free 3-month treasury bill yielding only .13% and the 1-year treasury yielding .39%, the only ways to increase yield are to take on additional credit risk by purchasing lower-grade investment securities or by buying longer-dated paper, exposing the investor to interest rate risk.

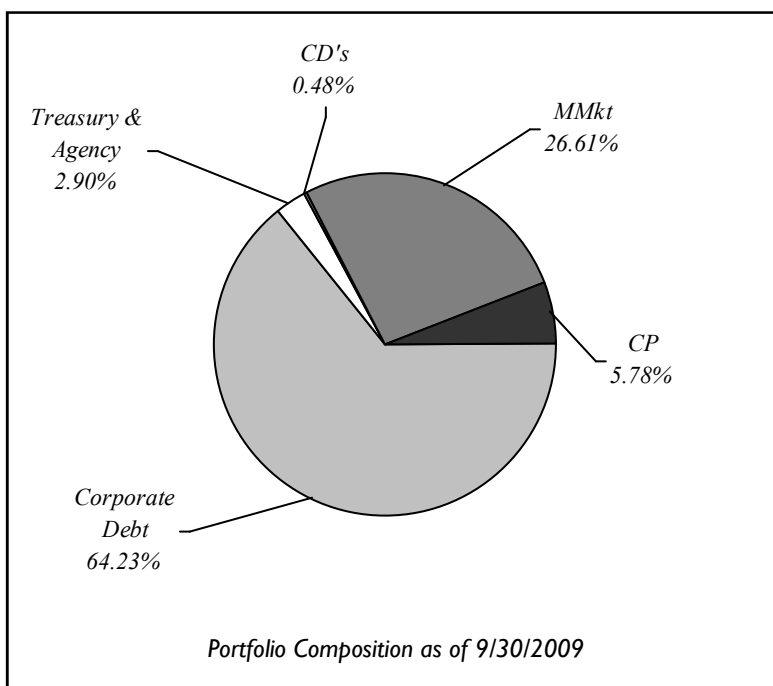


Figure 1

ond quarter of 2008. Fed policy makers acknowledge economic activity has picked up, and will maintain policies to support economic growth. Inflation is likely to remain subdued for some time, and various Fed Governors have indicated the Fed Funds target rate will likely remain unchanged from its current level of 0-25 basis points into 2010.

Key Rates	Current September 2009	Prior Quarter June 2009	Year Ago September 2008
Fed Funds Target	0 – 0.25	0 – 0.25	2.00
3 Month Treasury	.13	0.18	.53
3 Month LIBOR	.29	.63	4.05
30 Day AI/PI CP	.24	.25	3.99
1 Year Treasury	.39	.46	1.55
2 Year Treasury	1.02	1.32	1.73

Portfolio Summary as of 9/30/2009

Average adjusted maturity	58 days
Maturing or repricing within 30 days	44%
Maturing or repricing within 90 days	87%
360-Day Basis Yield on 9/30/2009	.75%
365-Day Basis Yield on 9/30/2009	.76%

Banking Update: Formal Enforcement Actions (continued)

are needed to restore the bank to sound condition and full compliance with banking regulations. Enforcement actions also typically set timetables for required corrections to take effect.

Enforcement actions in Utah can be issued by one of several federal bank regulators or the Utah Department of Financial Institutions, depending on how the institution is organized and where it is chartered. Federal bank regulators that issue enforcement actions include the Federal Deposit Insurance Corporation (the “FDIC”), the Federal Reserve (the “Fed”), the Office of the Comptroller of the Currency (the “OCC”), the Office of Thrift Supervision (the “OTS”), and the National Credit Union Administration (the “NCUA”).

There are two broad categories of enforcement actions: Informal and formal. Unlike informal enforcement actions, formal enforcement actions are legally enforceable. They also can serve as a basis for the imposition of civil money penalties if violated, and are published and publicly available on regulators’ websites.

Regulators impose formal enforcement actions for violations of laws, rules, or regulations, unsafe or unsound practices, breaches of fiduciary duty, and violations of final orders or other conditions imposed by regulators in writing. Depending on the nature of the corrective action and the issuing agency, the types of formal enforcement actions used by regulators vary widely and include:

- Consent orders
- Cease and desist orders
- Temporary cease and desist orders
- Formal agreements
- Written agreements
- Removal and prohibition orders
- Orders assessing civil money penalties
- Prompt corrective actions

The most common forms of formal enforcement actions placed into effect on Utah financial institutions in recent months are FDIC Cease and Desist Orders and Fed Written Agreements.

What Formal Enforcement Actions Say

Each formal enforcement action is unique and designed to

address each bank’s deficiencies in specific terms. However, the documents have ample “boilerplate” content and make consistent and recurring use of certain terms and phrases.

Following are quotes from FDIC Cease and Desist orders issued to Utah financial institutions this year. As a reflection of common challenges faced by banks in this environment, the FDIC frequently cites deficiencies with respect to capital adequacy, liquidity, management, loan quality, and other issues, asserting that the subject bank is operating:

- with management whose policies and procedures are detrimental to the Bank and jeopardize the safety of its deposits
- with a board of directors which has failed to provide adequate supervision over and direction to the active management of the Bank
- with a large volume of poor quality loans
- with inadequate provisions for liquidity
- in such a manner as to produce operating losses and
- with inadequate capital in relation to the kind and quality of assets held by the Bank

Capital deficiencies are commonly noted within recent formal enforcement actions, and are of special concern as there can be a critical link between capital inadequacy and eventual bank failure. Banks with inadequate capital are often provided between 30 and 120 days to remedy their deficiency.

The range of restrictive requirements outlined within formal enforcement actions is very broad: The actions may place restrictions on the hiring of senior bank officers, the payment of dividends, and the means by which banks raise new capital, as examples.

Corrective Actions

According to Tom Bay, Supervisor of Banks at the Utah Department of Financial Institutions, “formal enforcement actions are really corrective plans agreed to by the regulators and the bank. The goal is to bring the bank back to health with regulatory support.” Historically, most banks which become subject to enforcement actions respond positively to the correction and emerge stronger once they are able to come into compliance with the action’s terms.

(continued on page 4)

Federal Regulator	Primary Type	Web Link to Enforcement Actions
FDIC	Order to Cease and Desist	http://www.fdic.gov/bank/individual/enforcement/neworders.html
Federal Reserve Bank	Written Agreement	http://www.federalreserve.gov/newsevents/press/enforcement/2009enforcement.htm
OCC	Formal Agreement	http://apps.occ.gov/EnforcementActions/
OTS	Order to Cease and Desist	http://www.ots.treas.gov/?p=EnforcementSearch
NCUA	Order to Cease and Desist	http://www.ncua.gov/Resources/AdministrativeOrders/index.aspx

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Banking Update: Formal Enforcement Actions (continued)

An Intriguing Development

The FDIC's August 28, 2009 monthly summary of July 2009 enforcement actions included the following disclosure: "Beginning with this press-release, the FDIC is including a new section listing Notices issued during July 2009. The FDIC will continue to publish information on Notices issued in future monthly press releases covering enforcement actions and orders." A reading of one of such Notice reveals a very detailed and unflattering account of a financial institution in Georgia that, among other things, is allegedly manipulating and misstating its quarter-end capital amounts, according to the FDIC.

Such notices are nothing new, but their immediate publication by the FDIC represents an interesting shift in the regulator's approach, and it highlights an important part of the formal enforcement process. Once regulators deliver a formal enforcement action to a bank, the bank has the

option to negotiate or contest the terms of the enforcement action through an administrative hearing process. It is in response to such requests for negotiation that the FDIC issues the Notice of charges. Historically, once a bank indicated its unwillingness to immediately comply with an enforcement action, the Notice was issued and any discussions that ensued were "taken off line," without immediate publication of the Notice. This shift in policy by the FDIC increases the transparency of the enforcement action process, and seems to reflect a growing intolerance for banks that might seek to thwart or delay the process by choosing not to consent outright.

As a practical matter, most banks understand their condition and regulators' concerns, and therefore accept enforcement actions via stipulation and consent, perhaps recognizing that there's little to be gained from taking an uncooperative stance with regulators.

LaJuan Williams-Dickerson, media contact with the FDIC's Office of Public Affairs, stated that publication of these Notices has been authorized by statute for quite some time, but the FDIC had simply not opted to publicize the Notices previously.

Taking a Closer Look

Mr. Bay encourages public treasurers to take the time to understand what's really going on with a financial institution that is dealing with a formal enforcement action. "Make the effort to find out more about why the bank is subject to the enforcement action. Review the bank's financials, call the bank, openly express your concerns, and ask the bank what's being done to correct the situation." Mr. Bay also invites concerned treasurers to contact the Department of Financial Institutions at (801) 538-8830 with questions or concerns they may have about state-chartered banks or credit unions.